



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201245021**

Release Date: 11/9/2012

Date: August 14, 2012

UIL Code: 501.00-00

501.03-00

501.03-05

503.00-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

All Years

Dear

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038(CG) (11-2005)
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Holly O. Paz
Director, Exempt Organizations
Rulings and Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: June 20, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

B = Board Member
C = Board Member
D = Board Member
E = Religious Leader
N = State
O = Date
P = Date
Q = Date
R = Date
S = Religious Organization (seller)
T = Organization (tenant)
V = Organization (tenant)

UIL:

501.00-00
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Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issue

Do the available facts show that you have failed the operational test, therefore disqualifying you from exemption under Section 501(c)(3) of the IRC? Yes, for the reasons described below.

Letter 4036(CG) (11-2011)
Catalog Number 47630W

Facts

You were incorporated in the state of N on P by an initial group of six individuals. D, a current trustee, was part of your initial incorporators. Your other trustees, B and C, were not part of that initial group.

Your purpose as listed in your organizing document is to conduct and maintain a house of worship with the traditions of the Orthodox Jewish faith and conduct all communal affairs necessary for a viable Jewish Community.

Your financial information submitted with your Form 1023 indicated you have had no revenue and no expenses since formation. You describe yourself as "a congregation without any income, fund raising or dues."

Your balance sheet shows you have an investment worth more than \$2 million, which you describe as a property. You provided documentation showing you purchased a property from S, another religious organization. The property is located at the same address you have listed as your address on your Form 1023. The date of the sales contract was Q, two months prior to your formation, and the date of transfer of the title was R, about a year after your formation.

Your balance sheet also lists a mortgage liability of more than \$1.6 million. Around \$1.5 million is listed as a mortgage from a bank and the remainder is listed as purchase money from the seller, S. You also list another liability, a loan payable to T, a tenant of your property, worth more than \$600,000. Your mortgage was obtained based on the income generated by the lease you have with your tenant. The lease agreement and loan payable are described in more detail below.

You describe your property as a building that was used as a Jewish synagogue for almost 40 years and that you plan to use the building for similar purposes. You explain for the entire history of the building, in addition to prayer services, there has been a school at the premise. Currently, T and V operate at this facility, leasing the building from you. T and V are both 501(c)(3) entities. V operates as a school. T is formed to engage in charitable endeavors to support the education of students at V. V does not provide any religious services, while T provides programs for religious and cultural enrichment. You state that you are not involved in any of the educational or enrichment programs at the school. They have been located at this building for around six years before you purchased the building. T and V use 100% of the facility and they have had 100% use for around eight years. They permit you to use a room for your services. You use the space only when the tenant is not using the space.

You have no minutes where decisions were made to form the organization, obtain a loan, or purchase the property. The decision to purchase the property was made by

your board and with the people from V.

You initially explain that you lease the building to V under a net, net lease, where V pays the entire mortgage payment of more than \$11,000 a month, to the lender, along with all the expenses related to owning and operating the building. You state you do not make any income as a result of the lease and that no money or anything of value is exchanged between you and V. The tenant pays all expenses because it uses 100% of the building.

You then provided a copy of a signed lease agreement between you and T / V. This document lists you as the landlord and T / V as the tenant. The lease agreement is dated O, more than six months prior to your purchase of the property. The lease is for ten years. Part 3 of the lease states "Nothing herein contained shall require or be construed to require tenant to pay any interest or principal payment on any mortgage on the fee of the demised premises or any part thereof." Part 4 of the lease states the tenant shall pay you, the landlord, basic net rent at a monthly rate approximating \$12,000 and shall be paid to your office. Part 8 of the lease details that payments for taxes, water, and sewage on the property will be paid monthly to you. Part 48 of the lease reserves your right to use the facility for religious services, so long as it is not during regular school hours, and that you will not pay to use the facility.

When asked about the inconsistencies between your description of your rental arrangement and the signed agreement, you explained the lease is a boiler-plate standard commercial lease from a lawyer and, "we cannot reconcile every word in the lease with our ongoing relationship with the tenant." You then described the current arrangement, which is that the tenant pays the monthly mortgage costs directly to the lender and no money flows to you. You explained that you have never needed to enforce anything with your tenant, as they have never attempted to escape paying obligations to the lender, the utility company, or other property-related costs. Bank statements provided confirm no payments are made to you. You do not consider the mortgage payments made by the tenant to the lender to be income to you because you do not see any income from the arrangement.

The loan from T was made to allow you to purchase the facility. There is no written loan agreement. The loan can be in place as long as your lease is in place. Interest on the loan will be paid at the time the loan is paid based on the minimum interest rate allowed. When asked about repayment of the loan, you first explained you will repay the loan by refinancing the first mortgage or by taking out a second mortgage. You subsequently explained your goal of refinancing will happen when and if it becomes necessary, though there is no present necessity. You later explained you are not obligated to make any repayments of the loan, as you are on friendly terms with the tenant. You may eventually fundraise, seek another loan, or obtain another mortgage to repay the loan, but the loan will never be forgiven.

When asked why you are purchasing the building, you explain that T could have purchased the property, but continuing tradition of having a religious congregation own the property was the operative factor in having a congregation own the property. You explain that the property has been owned by a religious congregation for more than 40 years and it was considered the appropriate and respectful thing to have another religious congregation continue that tradition. When asked what the tradition requiring you to purchase the property was, you explained that there is a tradition of prayer services at the property and that if the property was sold for business or recreation purposes, the religious tradition would have been broken and contrary to the sacred use of the property. You were created to best carry on the tradition of the former owner, which was a synagogue.

In response to a question about inconsistencies in the repayment of your loan with T, you explained that "the business operations of our Congregation do not create inconsistencies." You were created to continue the operation of a Synagogue at the property and that to finance the purchase, a mortgage was obtained. You explained that the school that was operating there wanted to remain there, and so the school provided you a loan. You don't have a payment schedule because you cannot have any income until you have tax-exempt status, and that there are many ways you might repay the loan, including refinancing. You state you will be solvent and have income after you receive tax-exempt status.

You conduct worship services for approximately 15 people. You have morning prayer services and late afternoon prayer services, led by your religious leader, E, which are held at your property. You also explain that most of the people attending the services are students and faculty of the school, though they are open to anyone, and that staff and students sometimes attend services before the school day. You do not conduct prayer services on the Jewish Sabbath because your members do not drive on the Jewish Sabbath and there are not enough members within walking distance to constitute a quorum of 10 men above the age of Bar Mitzvah. You hope eventually to be able to meet that requirement.

You are trying to attract new worshippers for Sabbath services. You do not have newsletters, brochures or similar documents. You advertise your services by word of mouth and the signage in front of the school. You provided photos of your sign, which states "Join Us For Services" and lists your service times as Friday evening around 9:00 p.m. and Saturday morning at 9:30 a.m. When asked about the discrepancy between your described service times and your advertised service times, you explained that the sign is from the previous owner and that you kept the service times to inform the public about the possibility of prayer services if you ever achieve the needed quorum. You do not advertise your weekday services because few people in the neighborhood are interested in daily services.

Law

Section 501(c)(3) of the Code describes corporations organized and operated exclusively for charitable purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities in not in furtherance of an exempt purpose.

Rev. Rul. 58-547, 1958-2 C.B. 275 states that the lease of property under ordinary commercial arrangements does not constitute the exercise of an educational or charitable function in and of itself. Only when it is shown that the lease is for purposes substantially related to the exempt functions of the lessor does the above exception apply. The fact that the lessee may be an exempt educational organization does not cause the rental of space thereto to become a related activity on the part of the lessor who may be organized in part for educational purposes.

Rev. Rul. 69-572, 1969-2 CB 119 provides that a nonprofit organization, created to construct and maintain a building for the exclusive purpose of housing and serving exempt member agencies of a community chest, may be exempt under section 501(c)(3) of the Code.

Rev. Proc. 2011-4, 2011-1 R.B. 123, provides that an organization seeking exemption must fully describe all of its activities including standards, criteria, and procedures.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In Nelson v. Commissioner, 30 T.C. 1151, 1154 (1958) the court stated that the applicant for tax exempt status under Section 501(c)(3) has the burden of showing it "comes squarely within the terms of the law conferring the benefit sought."

Christian Echoes Nat. Ministry, Inc. v. U.S., 470 F.2d 849 (1972) stated that that tax exemption is a privilege, a matter of grace rather than right.

In Harding Hospital, Inc. v. United States, 505 F.2d 1068 (1974), the court held that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the court found that a corporation formed to provide consulting services was not exempt under section 501(c)(3) because its activities constituted the conduct of a trade or business that is ordinarily carried on by commercial ventures organized for profit. Its primary purpose was not charitable, educational, nor scientific, but rather commercial. In addition, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organizations. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost."

In Living Faith Inc. v. Commissioner, 60 T.C.M., 710, 713(1990), aff'd 950 F.2d 365 (&Cir. 1991), the court found that Living Faith operates with a substantial commercial purpose and is therefore not entitled to 501(c)(3) tax-exempt status. "It is difficult to see how the experience of dining or shopping at Living Faith's restaurant and health food stores differs, if it does, from the same experience one might have while dining or shopping at other vegetarian restaurants and health food stores. Granting a tax exemption to Living Faith would necessarily disadvantage its for-profit competitors. We do not doubt the sincerity of Living Faith's beliefs, and we recognize its good faith in asserting a religious purpose of health promotion. Based on the record before us, however, we must uphold the Tax Court's determination that Living Faith operates with a substantial commercial purpose as well."

Application of Law

You are not operated exclusively for charitable, educational, or religious purposes under section 501(c)(3) because you have the substantial non-exempt purpose of purchasing and leasing a facility in a commercial manner. Because of this substantial non-exempt purpose, you fail the operational test under section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations.

More than an insubstantial part of your activities are dedicated to the non-exempt purpose of purchasing and leasing a property, as evidenced by your financial information. Your assets are your property and your liabilities are a mortgage and a loan used to purchase the property. Your only revenue is the rent from your tenant,

which bypasses your bank accounts and is paid directly to the mortgage company. Your only expense is the payment of your mortgage, as your agreement with your tenants requires them to pay all the expenses (taxes, utilities, etc.) of owning a property. Therefore, you are not "operated exclusively for one or more exempt purposes" as set forth in section 1.501(c)(3)-1(c)(2) of the regulations.

Your rental agreement is similar to the arrangement described in Revenue Ruling 58-547. Even though you are renting your facility to exempt organizations which conduct educational and religious activities, the nature of the rental agreement is still commercial. You describe your lease agreement as "a boiler-plate standard commercial lease." Your only revenues and expenses relate to the rental income derived from your tenant, T, paying rent directly to the mortgage company, and your only expense is your mortgage payment. The tenant is covering all of the mortgage expenses and all ancillary costs associated with the building, which is similar to a standard commercial lease. In addition, you state you have no involvement in the programs with your tenants, thus showing that leasing this facility to your tenants is not substantially related to your purposes, and is therefore commercial. A substantial commercial purpose precludes you from exemption under 501(c)(3).

Similarly, you are distinguishable from the organization in Revenue Ruling 69-572, in which an organization leases office space in a building to 501(c)(3) organizations. In this ruling, an organization was found to be exempt under 501(c)(3) who leased the space at rates substantially less than the general commercial rate and shares a close relationship between its purposes and the functions of the tenants. In contrast, you are renting the facility to your tenants for the exact amount of the mortgage expense, along with all utilities, taxes, and other building expenses, which is similar to a standard commercial lease. In addition, you have no stated involvement in the programs of your tenants, showing there is no relationship between your purposes and your tenant's purposes. The factors show that purchasing and leasing the facility is unrelated to your exempt purposes of conducting religious services, and therefore, does not further your exempt purposes. Therefore, this substantial non-exempt purpose precludes exemption under 501(c)(3).

You have failed to describe your operations in sufficient detail to show that you are furthering an exclusively religious, educational or charitable purpose as required by Revenue Procedure 2011-4. You have failed to explain how purchasing and leasing this property will further exclusively religious purposes. You explain that the decision to purchase the property was made because it was decided a religious congregation should own the property. This is supported by the fact that the sales contract to purchase the property was entered into months before your formation date, P, and you signed a lease with your tenant prior to the property title being transferred to you. In addition, your tenant, V, was involved in your decision to purchase the property. Your mortgage was also granted based on the income generation by the lease with T and V.

This demonstrates the intent behind your formation was to purchase this property and lease it to the tenant. The purchasing and leasing of this property is a substantial non-exempt purpose which precludes exemption under section 501(c)(3).

As noted in Nelson v. Commissioner, Christian Echoes Nat. Ministry Inc., and Harding Hospital, Inc. v. United States, the burden is on the applicant organization to demonstrate that it has met the operational test as specified under section 501(c)(3) of the Code. You provided no documentation substantiating how the purchase and rental of this property was related to your religious purposes, other than continuing a tradition of congregations owning the property. You state that T could have purchased the property. Instead, T provided you with an undocumented loan worth more than 25% of the property, with no required repayment schedule. When explaining why you purchased this property, you stated the need to have a religious congregation purchase this property caused your creation. The details surrounding your formation show that you were formed primarily to purchase and lease your property. With no substantiation of how this arrangement relates to your exempt purpose, this arrangement is similar to a commercial enterprise, disqualifying you from exemption under section 501(c)(3).

As stated in Better Business Bureau of Washington, D.C., Inc. v. United States, the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes. Thus, even though you hold religious services, your operations include the substantial commercial purpose of leasing 100% of your property to a third party at full cost, which precludes exemption under section 501(c)(3).

The renting of a facility is a non-exempt purpose without any charitable or religious elements. Similarly to the organization in B.S.W. Group, Inc. v. Commissioner, your financing consists only of rental income, which bypasses your bank accounts by being paid directly to the mortgage company by the tenant. The rental income is the exact amount of your mortgage payment, set to recoup all projected costs of owning the property. There is no indication you will ever charge a rental fee that is substantially below cost. Even though you conduct religious services, your finances show you have a substantial commercial purpose of renting your facility to a third party.

You are similar to the organization described in Living Faith Inc. v. Commissioner, who was denied tax exemption due to the commercial nature of their operation. While you do have some religious purposes, your rental activity is indistinguishable from a commercial business. The fact that this activity accounts for all of your revenues and expenses shows this is a substantial purpose of your organization, precluding you from tax exemption under 501(c)(3).

Applicant's Position

You insist you are formed for the purpose of operating a house of worship, and that in order to fulfill this purpose, you obtained a mortgage and loans to purchase your property.

Service Response to Applicant's Position

As stated above, a substantial portion of your activities consists of purchasing and leasing a property to T and V. This is evidenced by several factors. First, your revenues, expenses, assets, and liabilities revolve entirely around the purchase and rental of this property. Also, your tenant, V, was included in the discussions to purchase the property. The sales contract date for the purchase of the property was months prior to your formation, and the written lease agreement provided was signed more than seven months prior to the transfer of the property title to you. In addition, your reasoning for your creation was that a religious congregation should continue holding title to the property. This shows the intent behind your creation was to allow you to purchase, hold title to and subsequently lease this property to T and V. Holding title and leasing property at market rate is not an exclusively charitable or religious activity. Therefore, even though you have religious activities, this substantial rental activity precludes exemption.

Conclusion

Based on the facts presented in your application, we conclude that you are not tax exempt under section 501(c)(3) of the Code because you do not meet the operational test outlined in section 1.501(c)(3)-(1)(c) of the Regulations. It is clear that you were formed for the substantial purpose of purchasing and leasing a facility to a third party at market rate. This activity is not exclusively religious or charitable, but is carried on in a commercial manner. Despite any religious, charitable or educational purposes your activities may achieve, you cannot qualify for tax exemption because more than an insubstantial part of your activities is not in furtherance of exempt purposes.

Accordingly, you are not exempt under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure, Publication 892